

Service Date: December 7, 1984

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

IN THE MATTER of the Application)	UTILITY DIVISION
of the City of Livingston to increase)	DOCKET NO. 84.1.5
Water Rates.)	ORDER NO. 5050a

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FINAL ORDER

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APPEARANCES

FOR THE APPLICANT:

Bob Jovick, City Attorney, 414 East Callendar, Livingston, Montana 59047

FOR THE INTERVENORS:

John Allen, Staff Attorney, Montana Consumer Counsel, 34 West Sixth Avenue, Helena,
Montana 59620

FOR THE COMMISSION:

Opal Winebrenner, Staff Attorney, 2701 Prospect Avenue, Helena, Montana 59620

BEFORE:

John Driscoll, Commissioner and Hearing Examiner

BACKGROUND

1. On January 19, 1984, the City of Livingston (Applicant or City) filed an application with this Commission for authorization to increase water rates to its Livingston, Montana customers on a permanent basis by approximately 54%, which constitutes an annual revenue increase of approximately \$151,250.

2. Concurrent with its filing for a permanent increase in rates, the Applicant filed an application for an interim increase in rates of approximately 27%, equaling a revenue increase of approximately \$75,625 or 50% of the proposed permanent increase.

3. On March 6, 1984, the Commission, having considered the data filed with the Applicant's interim application, issued Order No. 5050 granting the City interim rate relief in the amount of \$54,087 annually.

4. On September 11, 1984, pursuant to notice of public hearing, a hearing was held in the Community Room, City-County Building, Livingston, Montana. The purpose of the public hearing was to consider the merits of the Applicant's proposed water rate adjustment. At the close of the hearing, the parties stipulated to allow the Commission to issue a final order in this Docket.

FINDINGS OF FACT

5. At the public hearing, the Applicant presented the following witnesses:

Bill Dennis, City Council Member, Chairman of Water Committee
John Orndorf, City Superintendent
John O'Connell, Consulting Engineer

These witnesses testified concerning the operating losses sustained by the water utility during the last three (3) years, the failure of the City to meet the requirements of its revenue bond indenture insofar as it relates to the 130% bond coverage ratio, the fact that the City has deferred maintenance on capital items, and the City's proposal to issue additional revenue bonds for a major capital improvement program.

6. The Montana Consumer Counsel presented the testimony of public witness Lester Sunvison. The main concerns expressed by Sunvison were the magnitude of the proposed rate increase and its impact on fixed income consumers.

OPERATION AND MAINTENANCE EXPENSE

7. The test year in this case is the fiscal year ending June 30, 1984, during which the Applicant incurred operation and maintenance expenses totaling \$284,032. The Applicant, for rate case presentation, developed budgeted fiscal year 1985 operation and maintenance expenses, using

fiscal year 1984 as a base for all projections in its budget presentation. A partial listing of adjustments made to the 1984 actual operation and maintenance expenses for development of the budgeted 1985 expense include: a reduction in chemical expenses, an increase in Montana Power Company utility expense, a salary increase to reflect the additional expense for a backhoe operator, and an increase in transfers to other funds.

8. The projected operation and maintenance expenses were not challenged by any party participating in this proceeding. Discussion of the major expense modifications, however, is warranted to insure the reasonableness of those modifications.

9. The Applicant has projected that it will experience a reduction in its cost of chemicals because of its discontinuance of a surface supply source and abandonment of treatment facilities associated with that source. It is the Commission's understanding that the City has totally converted the water utility to a ground water source of supply, relegating the surface water supply source to emergency standby status. Conversion from a surface source of supply to a ground water supply source should result in a reduction in chemical expenses because ground water, generally, requires significantly less treatment than surface water. The Commission accepts the projected reduction in chemical expense.

10. The Applicant indicated that an increase in electrical utility expense would be experienced with its conversion to a 100% ground water source of supply. The City's witnesses stated that the increase in electrical expense would occur because the electrical cost of pumping water from the ground supply source exceeded the electrical cost of operating the treatment plant.

The increase in electrical expense appears to be reasonable, given the fact that the surface supply source was a gravity flow system requiring limited pumping to introduce water into the distribution system. To get water from the ground source requires 100% pumping to place the water into the distribution system.

11. During fiscal year 1984, the water utility purchased a backhoe which will be used, by the Water Department, in connection with its ongoing maintenance program. The backhoe will also be a source of revenue generation, through its rental to other City departments. The Applicant has requested that the Commission authorize an increase in salary expense sufficient to allow the

City to hire an additional employee to operate the backhoe. The Commission finds the City's request to hire an additional employee to operate the backhoe to be reasonable. The Commission finds that new employee will eliminate the City's need to hire outside contractors to do its excavations, at a possible higher cost to the consumer, and that it is a source of revenue generation for the water utility.

12. The Applicant has made an adjustment increasing "Transfers to Other Funds" which is the account for reimbursement of administrative services provided by employees not directly assigned to the Water Department. This increase results from the City's reexamination of actual administrative time devoted to the Water Department, and determining new allocation percentages applicable to the salaries of the various administrative employees. This adjustment is accepted by the Commission as reasonable because an ongoing review of administrative costs is prudent, and insures that no one department is being unjustly charged for administrative expense.

13. The Applicant has proposed that the Commission, for fiscal year 1985, accept total operation and maintenance expenses of \$350,254. The Commission, upon review of the Applicant's proposed operation and maintenance expenses, finds the expenses to be reasonable and therefore, accepts expenses totaling \$350,254.

RECURRING ANNUAL CAPITAL IMPROVEMENTS

14. During the course of the public hearing, the City's witnesses indicated that maintenance to prolong the useful life of capital items had been deferred, and that purchase of needed capital items had been delayed, due to insufficient revenues. The City, in this filing, is proposing that the Commission grant revenues which are sufficient to allow for a Recurring Annual Capital Improvement Program (RACIP). Granting revenues which are sufficient to allow for the funding of a RACIP, in the City's view, would enhance the City's ability to provide reasonably adequate water service and maintain the integrity of the current facilities.

15. In its budgets, the City included RACIP funding at the level of \$85,599 and \$55,457 for fiscal years 1985 and 1986 respectively, for an average funding level of approximately \$70,500 annually. Funding at this level would allow the City the ability to acquire twenty-four (24) capital

items it has determined necessary for proper operation of the water utility. (See annual budget estimates)

16. The Commission fully supports the adequate funding of a RACIP when that funding is tied to a schedule of contemplated system improvements. The City, in this instance, has requested funding for a RACIP and tied it to a contemplated schedule, but the Commission is hesitant to grant funding at the annual level requested by the Applicant.

The City's witnesses testified that it is anticipated that the City will be issuing additional revenue bonds during fiscal year 1985. The proposed bond issue, as outlined by the City witnesses, will be for a principal amount of approximately \$1,237,700, and will be issued on parity with a currently outstanding revenue bond issue. The proposed bond issue, being issued on parity, with the currently outstanding bond issue will require that the proposed bond issue provide a debt service coverage ratio of 130%.

The funds generated by the 130% coverage ratio are unencumbered funds of the water utility, and can be used to pay for a portion of the RACIP. Assuming the City issues \$1,237,700 in revenue bonds to be repaid over a period of 20 years with a maximum interest rate of 11%, the City will have available approximately \$46,000 annually from the coverage ratio, that can be used to fund the RACIP.

17. In fiscal year 1984, the Applicant budgeted \$40,000 for its RACIP. The Commission finds that until there is a resolution passed by the City Council regarding the issuance of additional revenue bonds, no increase in this expenditure should be allowed. As previously discussed, the level of funding authorized for this account can be directly affected by the covenants of the proposed revenue bond issue.

DEBT SERVICE

18. The City has a current outstanding water revenue bond with an annual principal and interest payment of approximately \$22,024, and a coverage requirement of 130%. One of the concerns expressed by the City, in its filing, was its failure to meet its bond indenture requirement to have a 130% coverage ratio.

To meet the 130% coverage ratio requirement, the City must have net operating income of at least \$6,607. To determine net operating income, operation and maintenance expense, as well as debt service, are subtracted from the total revenues of the utility. Funds available for RACIP are not considered operating expenses. The \$40,000 allowance for the RACIP account in Finding of Fact No. 17 more than satisfies the 130% coverage requirement.

19. Based on Findings of Fact Nos. 13, 17, and 18, the Commission finds the following test year operating revenue deductions to be reasonable:

Operating Expenses	\$350,254
Debt Service	22,024
RACIP	<u>40,000</u>
TOTAL	\$412,278

REVENUE NEED

20. The City indicated that, under present rates effective May, 1983, user charges would generated approximately \$280,496 in annual revenues. The test period user charge revenues are not a contested issue in this case and are, therefore, accepted by the Commission.

21. During the course of cross-examination, it was determined that user charges are not the only source of revenue for the City's water utility. The City, in its budget for fiscal year 1985, indicated that it would realize total revenue from "Other Income" in the amount of \$43,700. This "Other Income" will be generated, in part, from: Sales of Service to Other City Departments, Interest Earnings, Parking Stall Rentals, Rental of Backhoe and Operator, Service Line Installations, and Sewer Line Excavations.

The expenses associated with those revenue sources have been included in the operating statement of the water utility. These "Other Income" revenues should be included, for purposes of determining the water utility's overall revenue generation for the test period.

22. The Commission, based on Findings of Fact Nos. 20 and 21, finds that total test period operating revenues are \$324,196.

23. The Commission, based upon the Findings of Fact contained herein, finds that the Applicant should be allowed to increase annual revenues by \$88,082. This requirement is calculated as follows:

Operating Revenues	\$324,196
LESS:	
Operating Expenses	350,254
Debt Service	22,024
RACIP	<u>40,000</u>
Total Revenue Requirement	\$412,278
REVENUE DEFICIENCY	\$ 88,082

RATE DESIGN

24. The Applicant proposes to continue the current water rate structure, and to generate the increased revenue determined appropriate in this order by increasing rates for all water services on a uniform percentage increase. The currently effective rate structure includes a minimum charge and four declining block rates.

25. On cross-examination, the City's consulting engineer, Jonn O'Connell, stated that the water utility presently was operating at capacity during periods of peak demand. He stated that he could not justify the continuation of a declining block rate structure when the system was operating at capacity. He further stated, based on preliminary analysis, that it was his opinion that the tail block rate probably was not compensatory.

26. The Applicant's proposed declining block rates are in conflict with efficient resource management, and provide an incentive to increase consumption into lower priced tail blocks. To provide an incentive to increase consumption results in an inefficient allocation of the natural resource, and often times, as in this instance, necessitates an increase in plant capacity.

27. The City did not present a fully allocated cost of service study in its application, and absent such a study, the Commission cannot determine what the level of revenue contribution should be from each customer classification. Based on the testimony that the tail block rate for consumption

in excess of 4,000,000 gallons is probably not compensatory and the testimony that the system is operating at capacity, the Commission finds that the City should delete the tail block rate for consumption in excess of 4,000,000 gallons. Deletion of the tail block rate should result in more efficient management of the natural resource and discourage excessive consumption.

28. The Commission finds that the Applicant should generate the increased revenues granted herein by first re-rating all consumption in the presently existing 4,000,000 tail block at the rate level for block three that was effective in May, 1983. The City should then apply a uniform percentage increase to the remaining three rate blocks to generate the balance of the authorized revenue increase granted herein.

29. The Commission has not authorized a radical rate structure modification for the water utility because the City has stated that it needs to retain a consultant to do a fully allocated cost of service study to determine the cost of providing service to various customer classifications. The Commission would recommend that the City undertake such a study as soon as possible, because a cost of service study will insure that each customer classification is contributing its fair share towards the operation of the water utility.

CONCLUSIONS OF LAW

1. The Montana Public Service Commission properly exercises jurisdiction over the parties and subject matter in this proceeding. Title 69, Chapters 3 and 7, MCA.

2. The Montana Public Service Commission has afforded all parties interested in this proceeding proper notice, and an opportunity to participate Section 69-3-303, MCA, and Title 2, Chapter 4, MCA.

3. The rates approved herein are reasonable, just and proper. Section 69-3-201, MCA.

ORDER

NOW THEREFORE, IT IS ORDERED by the Montana Public Service Commission that the City of Livingston Water Department shall file rate schedules which reflect an annual revenue

increase of \$88,082. These revenues are in lieu of, and not in addition to, the revenues granted in Interim Order No. 5050.

IT IS FURTHER ORDERED that the increased water revenues authorized herein be generated as provided for in Finding of Fact No. 28.

IT IS FURTHER ORDERED that the water rates shall not be effective until the new rate schedules have been filed and approved by the Public Service Commission.

DONE AND DATED this 3rd day of December, 1984 by a vote of 5-0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION.

JOHN B. DRISCOLL, Commissioner
and Hearing Examiner

THOMAS J. SCHNEIDER, Chairman

HOWARD L. ELLIS, Commissioner

CLYDE JARVIS, Commissioner

DANNY OBERG, Commissioner

ATTEST:

Madeline L. Cottrill
Commission Secretary

(SEAL)

NOTE: You may be entitled to judicial review in this matter. Judicial review may be obtained by filing a petition for review within thirty (30) days of the service of this order. Section 2-4-702, MCA.